PUBLIC POLICY CONCERNING FRANCHISE VALUES —A PROBLEM IN TAXATION.

FRANCHISES to public service corporations for the carrying on of public service industries have been granted liberally, even lavishly, by American communities. In many cases such franchises have been of great value immediately, and in other cases they have grown to have immense value in time, as the business has increased in volume and the cost of rendering service has declined, without corresponding decrease in charges for service. There is rapidly growing in the public mind a conviction that the values and benefits inherent in public franchises of right belong to the public, and that such franchises ought not to be granted to private corporations on terms that carry to the recipient corporations values that might be reserved to the public itself, in one form or another.

A franchise, as understood in this connection, is not the conferring of a right to be a corporation, but is a grant by public authorities to a private corporation or individual of a privilege to use public streets or ground for the carrying on of a business that could not be prosecuted but for such grant of privilege. Strictly, such a franchise ought not to be a thing of great value. It is contrary to correct notions of public policy that it should be so. It must be presumed that the corporation or individual securing a franchise or grant of special privilege to perform a public service obligates itself to render such service at reasonable rates. This is the view of the matter taken by the courts, which construe reasonable rates to be rates that will permit a reasonable profit on money invested in the undertaking. If this presumption were constantly adhered to in practice, franchises would not have enormous value. The great value of a franchise is due to the very large earning power of the company holding the franchise; and this large earning power in turn is due usually to the maintenance of charges for service

that are unreasonably high. The reduction of charges to a reasonable basis, therefore, would mean the wiping out of much of the franchise value. In so far as public service corporations are permitted to maintain charges for service that make possible enormous franchise values, they may be said to tax the users of such service for their own enrichment. It is contrary to wise public policy to permit such taxation for private benefit, and, as has been said, there is a growing insistence that, when new grants of franchises or renewals of expiring grants are made, the terms shall be such that the public will reserve to itself in some form a large portion at least of the franchise value. Even where grants are not expiring, there is noticeable on the part of the public authorities all over the United States a disposition to take for the benefit of the public some part of the franchise values enjoyed by the franchise-holding corporations, either through increased taxes on franchise values or through attempts to lower charges under the regulating power of the government.

Where new grants or renewals of expiring grants are under consideration the question presented is, what form shall the reservation to the public of franchise values or benefits take? This question is one that is likely in the near future to become a matter of serious controversy in the field of practical politics. Moreover, the controversy is as likely to cause divisions along class lines as any that could be raised in this country. Instinctively the heavy property owners, acting from motives of self-interest, and especially realty owners, who must bear a large share of the burdens of taxation, will favor the policy of money compensation for franchises, as a means of keeping down taxation that they may be called upon to bear. On the other hand, the wage-earners and other persons of small means who are users of the service rendered by franchise-holding corporations, such as the street railways, but who pay little if anything directly into the public treasury, will as instinctively favor lower charges for service as against money payments into the public treasury designed to reduce general taxation.

The problem, in its nature, is clearly a problem in taxation.

The compensation taken from a public service corporation in return for a franchise grant is not, strictly speaking, a tax upon such corporation. So far as that corporation alone is concerned, the exaction is in the nature of a payment for a privilege or concession, akin to rental for the use of land. In reality, when the public authorities exact compensation for a franchise, they make use of the corporation as an agent to collect a tax from the user of the service, and to turn it over to the public treasury, for, presumably, when compensation is exacted for a franchise grant, the rates which the company is permitted by the grant to charge users of the service are higher by the amount of the compensation than they otherwise would need to be. In theory, at least, therefore, it would seem to be a matter of indifference to the company securing the franchise, whether it pays compensation therefor and collects correspondingly higher charges, or pays no compensation and renders the service at prices that leave no margin either for excessive and unreasonable profits or for money payments into the public treasury.

As between compensation for franchises and lower charges for service, the issue is between the users of the service on one side, and the heavy taxpayers of the community on the other, or in some cases, perhaps, those who ought to be heavy taxpayers and are not, and who wish to remain free from the burdens that might otherwise be imposed upon them.

The plan of raising revenue for public purposes by the levying of taxes upon the users of service furnished by franchise-holding corporations has the merit of convenience, and that merit alone. As a system of taxation, it is to the highest degree unjust and impolitic. The correct principle of taxation is that persons should contribute to the support of government according to their ability, and the amount of wealth possessed has usually been taken in this country as the best measure of ability to pay taxes. But to make persons contribute to the support of government according to the extent that they are obliged to patronize public-service corporations is to disregard any measure

of ability whatever; or rather, it may be said, it lays upon those least able to pay, the largest part of the burden of taxation, not only relatively, but absolutely. Take the street railways as an example. A plain statement of the situation is all that is necessary to indicate the injustice of this method of taxation. Probably no state or city government in this country would undertake to levy directly on every street-railway passenger a tax of one cent. Yet that is precisely what would be done, indirectly, were a city to grant a street-railway franchise, with a five-cent fare, upon the condition that the company receiving the grant pay to the city 20 per cent. of its gross receipts. For the city to take a smaller compensation, in lieu of reduction of fares, is merely to tax the passenger by a smaller amount per head. Now, there is no more reason why a passenger on a street railway should be taxed as such than there is why a like tax should be imposed on the person who rides over the public streets in a hack or an omnibus or in his own carriage. The special tax on the street-car passenger cannot be sustained on the ground that it is a payment for injury done to the street, because the street-railway passenger, as a part of his fare, actually pays for equipping and maintaining that part of the street directly used by him, namely, the rail, which, of course, is more than is done by the rider in a hack or omnibus or private carriage for street equipment and maintenance. In the days of horse-cars, when the horses used in drawing cars wore out pavements rapidly, it was natural and proper enough to require the horse-railway companies to pave and keep in repair the street between their tracks and for a short space outside. In many cases, this paving requirement of street-railway companies is still maintained, although the reason for exacting it no longer exists. The electric car does not wear out street pavements. In fairness, therefore, there is now no special reason why a street-railway company should be required even to lay down and keep in repair the paving between and immediately alongside its rails, except to the extent that it may actually injure the pavement in laying or relaying its rails.

The street car is nothing more nor less than a special kind of carriage, and to levy a tax for the privilege of riding over the public street upon the occupant of one kind of carriage and not upon the occupant of another kind, is an unjust, inequitable and unwarranted discrimination. To levy such a tax upon those who ride on street cars alone is particularly unjust, inasmuch as street-car passengers as a rule are much less able to bear the burden than those who ride in other kinds of vehicles. Moreover, the more limited, to a certain point at least, one's income is, the more proportionately is he likely to ride upon street cars, and therefore the more is he likely to pay in taxes levied upon street-car passengers as such. The street car is the poor man's carriage. Both in going to and from his work, and in his search for pleasure, the poor man of the city uses the street car; while the banker, business man, the professional man, and persons of wealth and leisure generally, ride to a considerable extent at least in other vehicles than street cars. The tax upon street-car passengers, therefore, is peculiarly a poor man's tax, for it exacts from the poor man not an equal but a greater contribution than from the rich man.

It is a mistake to suppose that the imposition of this tax is not felt by those who pay it, or that its removal would not be an appreciable benefit. The lowering of street-car fares, say from five to four cents, would mean a saving to the person who uses the street car daily in riding to and from his work, of at least twelve cents a week, or fifty-two cents a month. For a year of fifty-two weeks the saving would be $6.24. Taking into consideration the riding done beside that of going to and from work, the saving per person by a reduction of fare from five to four cents probably would be between $7 and $8 a year. The yearly saving by such a reduction to a family of five persons, two of whom regularly go out to work, might fairly be estimated at $20. This sum represents a larger amount than is paid directly in taxes by many small home-owners, and to say that the saving of such a sum would not be an appreciable benefit to the average family is simply absurd.

Not only is the imposition of a tax on street-car passengers an injustice and a hardship to those who make most use of street cars, but there is no reason why the property-owner and taxpayer should have his taxes reduced because of the construction of street railways. There is nothing that does so much to increase property values as cheap and adequate transportation facilities. It is especially inequitable, therefore, that the heavy property-owners who benefit as a class from the development of street railways, should have their taxes lowered at the expense of the users of such railways, who alone make possible their existence and development.

Thus far in this article the attempt has been made to show that the tax on the street-car passenger — taking the street-car passenger as a typical example of the user of a public service industry — is a peculiarly unjust tax. Turning now from consideration of the justice of this form of taxation to a consideration of its wisdom from the view point of public policy, we find still further grounds for criticism.

It is not easy to overestimate the importance of transportation agencies, and the more numerous the population the more important do such agencies become, and the more vitally do they affect the life and well-being of the community, both collectively and individually. The civilization of communities is measured perhaps more by the efficiency and cheapness of the means provided for moving about than by any other one thing. Quick and cheap transportation agencies not only facilitate business, but they increase the enjoyment of life in many ways.

The most effective way to prevent the growth of those harmful congested areas of cities known as slums is to provide cheap means of transit and thus enable the people to spread out over a larger territory, instead of crowding closely together as otherwise they are obliged to do. Reduce the car fares, and the slum population will grow smaller. Raise the car fares, or, what amounts to the same thing, prevent the possibility of reduction by taking for the use of the city revenues the imposition of which makes necessary the continuance of present rates of fare,

and the slum areas will multiply in number and increase in size. When philanthropists and public spirited citizens are urging the expenditure of large sums of money for the purpose of wiping out the slums, if possible, or at least of mitigating their evils, it would seem to be the worst kind of public policy to favor the maintenance of a tax, the imposition of which tends directly and powerfully to promote the growth of slum areas.

When the public authorities are spending large sums of money to provide parks for the people, everything possible ought to be done to make those parks available, by providing cheap means of transportation thereto. A tax upon every street car ride, by discouraging riding to and from parks, tends to defeat the objects of the public in establishing such parks.

It is not necessary to multiply examples of the benefits and importance of cheap transportation. Every consideration of wise public policy demands that the charge for transportation be made as low as possible. No public end whatever is served by making transportation dear as a means of raising revenue, as is supposed to be the case with such taxes as those upon liquor and tobacco, articles which are selected especially for taxation as a means of discouraging their use. Of all taxes that could be imposed, there is probably none that is so objectionable and ill-advised, from the view point of enlightened public policy, as the tax upon street car riding.

The city is supposed to hold the streets, not as property which it may properly exploit for gain, but in trust for the use of all the people. According to correct notions, it is an abuse of that trust for the city to put restrictions upon the use of the streets as a means of acquiring from those who use the streets revenue that ought to be raised by general taxation. The person who rides over the public streets in a street car ought to pay what it costs to carry him, and no more. The collection of more is an injustice and an imposition, whether the excess goes to swell the profits of a private corporation or is turned into the public treasury in the form of compensation. The city, as holder and guardian of the streets in trust for the people, ought

not to permit the continuance of such an imposition where the excess goes to a private corporation, nor should it deliberately sanction the continuance of such an imposition for the sake of securing thereby for the public treasury the excess that should never be taken from the people.

There is another phase of this trusteeship that is deserving of consideration. The city as trustee of the streets for the people ought not to surrender its right of continuing control over the streets any more than may be absolutely necessary. In other words, it is highly desirable that the grant to a private corporation of the right to make use of the streets for the purpose of rendering a public service should partake as much as possible of the nature of a mere license, subject to alteration or revocation at any time at the will of the public authorities. The less such a grant partakes of the nature of a contract, all the features of which are to remain fixed and unchangeable for the full life of the grant, the better for the public. The courts hold, as a general proposition, that definite term grants that have been acted on are contracts, but this general rule is subject to many modifications and limitations. For example, the public authorities are permitted in most cases[1] to reduce the charges for service, notwithstanding the fact that the charges may have been definitely prescribed in the grant, when a lower charge will produce a reasonable profit. Likewise, the public authorities are permitted to impose a large number of regulations in the interest of the public, even though such regulations may materially impair the value of the grant to its holder. This is all done on the theory that the city is trustee of the streets for the people, and that the city should not surrender its right to require corporations using the streets to use them in such manner as best to accommodate the public and at reasonable rates. Where grants are simple, merely giving the right to conduct the business, untrammelled by numerous specific conditions, the easier

[1] For recent court decisions on this point see Fergus *vs.* Rogers Park Water Company, 178 Illinois, 571, and 21 *Supreme Court Reporter*, 490; also, Freeport Water Company *vs.* City of Freeport, 186 Illinois, 179, and 21 *Supreme Court Reporter*, 494.

it is for the public authorities to exercise effective control as the interest of the public may require such control. But the city, by the form of the grant, may nevertheless hamper its future powers of control very much, and perhaps in no way more than by requirements of compensation. The insertion in a grant of a compensation clause is a complicating factor of much importance, because it greatly emphasizes the contract nature of the grant. The compensation, of course, is a direct consideration to the city by the recipient corporation for some or all of the privileges conferred by the grant. As a consequence of the passing of this consideration, the courts are likely to be much more reluctant to permit reductions of fare and regulations impairing the value of privileges paid for, even though the payment may have been grossly disproportionate to the actual value of the privileges conferred. The strict legal effect of such pecuniary considerations aside, the city imposing them as a condition of a grant would, to a considerable extent at least, be morally estopped from later attempts to reduce fares and to prescribe regulations that would impair the value of privileges. If the main object in granting a franchise is—as it should be—to secure good service at reasonable rates for the entire period of the grant, the exacting of money compensation for the grant tends to defeat that object by rendering it more difficult, practically if not legally, to secure reductions in charges as the business grows more profitable, and to compel such improvements in service as the spirit of progress and the developing needs of a community may make desirable.

In the very large cities the street railway is not the only local transportation agency. In such cities a heavy local and suburban business is done by the steam railroads, and in some instances there are elevated or underground roads, or both. To a considerable extent, these other transportation agencies are competitors of the street railroads. Whatever can be done to lower rates of fare on street railways, therefore, indirectly is likely to benefit those who use the steam or elevated or underground roads, by compelling the managers of such roads as a

means of preventing the diversion of traffic to the street railways, either to lower the fares on their roads by a corresponding amount or else to furnish better facilities as a means of holding their patrons at the established rates. A reduction of street-car fares, say from five cents to four cents, would immediately have a stimulating effect upon all the other local transportation agencies of the city, for all are to a greater or less degree competitors of the street railroads. By taking compensation for a street-railway franchise in lieu of a reduction of fares, therefore, the city treasury does not profit to the extent that the people are deprived of the benefit that would flow from a reduction of fares, since the lowering of street-car fares, as has been indicated, indirectly would benefit, not the users of street cars alone, but as well the users of all local transportation agencies that compete with the street railways.

The likelihood that a considerable portion of the tax on street-car passengers, collected by the company for the city, will never reach the city treasury, but will remain instead in the hands of the company, is another objection to this form of taxation. Some portion of taxes collected is always likely to stick in the hands of the collector. This is especially true where the collection of taxes is entrusted to a private corporation conducting a business for profit. As has been said, the city, in exacting compensation for a franchise, is in reality making the corporation receiving the grant its agent for the collection of a tax upon the users of the service. As every penny collected in taxes by the corporation and not turned over to the public treasury means so much more profit to the corporation, it is evident that there is a great temptation to the corporation to avoid turning over all the taxes collected by it. Moreover, as the money collected as taxes for the city by the company is, until turned over to the city by the company, kept as a part of the revenues of the company, there is a tendency on the part of the company to lose sight of the fact that it is a mere agent for the collection of taxes and to look upon itself as the bearer of the burden. Viewed in that light, the burden is conceived to be excessive and unjust,

and thus conscientious scruples against evasion of payment are more easily overcome, and a claim is likely to be set up to have the amount of the payment reduced, on the ground that it is excessive.

The city of Baltimore furnishes an illustration in point. I have been told that the company receiving the first street-railway grant in Baltimore offered the city the choice of two propositions. The company would establish a straight four-cent fare, with no compensation, or, it would charge a five-cent fare, and give the city 20 per cent. of its gross receipts. I have not verified the story as to the option offered the city between low fares and compensation. But the fact is that the franchise grant, made in 1859, did provide for a five-cent fare and did call for payment to the city of 20 per cent. of the company's gross receipts. What is the result? The 20 per cent. payment has long since been reduced to 9 per cent., without corresponding concessions to the city, and the company is now clamoring for a further reduction, on the ground that it is bearing an undue share of the burden of taxation. Had the original ordinance contained the stipulation for a four-cent fare in lieu of the provision for payment to the city of 20 per cent. of the gross receipts, there is much less likelihood that the people later would have been deprived of part of the benefit they supposed they were to derive from the grant. The incident cited from Baltimore represents the attitude of most public service corporations toward compensation agreements, when once entered into. There is constant pressure to secure reduction in the amount of the payment, and attempts at evasion are never ceasing; whereas, prices for service, when once established, can be raised only with extreme difficulty, if at all. A governing body that does its own tax collecting, without the aid of an intermediary corporation, will at least have the satisfaction of knowing that revenues not reaching the public treasury have never been taken from the pockets of the people.

In the foregoing statement of reasons for holding the exaction of compensation for franchises in lieu of a reduction of

charges for service to be unjust, inequitable, and contrary to wise public policy, the street railway has been taken as the type of the public service industry, and has been referred to specifically for purposes of illustration. The objections to exacting compensation for franchises, in lieu of reduction of charges for service, apply, however, with like force, in proportion to their importance, to all the public service industries, such as those for supplying light, water, and telephone communication.

To be sure, the practical statesman is sometimes confronted with a situation in which he is obliged to look for revenue wherever he can get it, and to disregard in large measure the justice of the process by which the treasury is replenished. A city in serious financial straits, and desirous of avoiding embarrassment until its revenue system can be adjusted and placed on a sensible and equitable basis, may be warranted in levying a tax indirectly on the users of service furnished by public service corporations. But such a tax should be looked upon merely as a convenient and practical expedient, designed to last a comparatively short period of time only, for meeting immediate and pressing difficulties. As a permanent means of raising revenue such a tax cannot be defended upon any grounds of justice or upon any consideration of public policy whatever, save that of convenience; and convenience alone is not an adequate and sufficient defense for a scheme of taxation.

There remains for consideration the question as to the relative merits of a tax on franchise values and of attempts to compel reductions in charges for service in cases where the franchise grants yet have a long time to run. Applying to this question the reasoning of the foregoing argument over the comparative merits of compensation for grants and of lower charges for service, the decision is against the special tax on franchise values and in favor of reduction of charges.

A franchise, of course, is property, and where it has value there is no good reason why the franchise should not be assessed and taxed like other property. But behind the prevalent agitation for the taxation of franchise values there seems to be a

notion that franchises are specially deserving of taxation and that special provision ought to be made to insure their assessment for purposes of taxation at their full value. Now, in so far as there may be any good reason back of the agitation for increased taxes on franchise values particularly, as distinguished from other property, there is justification for something far more radical. The franchise value is a gratuity bestowed by the public. If the value is so enormous as to excite demands for special taxation, the reason probably is that the company owning the franchise is maintaining charges for service that are excessively high and that make possible the realization of unreasonable profits. By attempting to tax these great franchise values, therefore, the public is taking for itself only a portion of that to which it is rightly entitled. The logical and proper thing to do is to order a reduction of charges and thus enable the people to secure the service furnished by the holder of the franchise at rates that will be reasonable and fair to all concerned. The legislature has the power, in most cases at least, to order such reductions, or to authorize city councils to order such reductions, where the prices charged are excessive, and in justice the legislature ought to exercise that power. As a plan of taxation, the special tax on franchise values is open to the same objections as were urged against the exacting of compensation for grants in lieu of reductions in charges for service. For public authorities to seek to promote social justice by attempts to increase the taxes on franchise values, rather than by ordering reductions of charges, is to go about the solution of an important problem in the wrong way.

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